VZCZCXRO1685
OO RUEHIK
DE RUEHTA #0049/01 0190949
ZNR UUUUU ZZH
O 190949Z JAN 10
FM AMEMBASSY ASTANA
TO RUEHC/SECSTATE WASHDC IMMEDIATE 7220
INFO RUCNCIS/CIS COLLECTIVE 2367
RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE
RUEHZL/EUROPEAN POLITICAL COLLECTIVE
RUEHBJ/AMEMBASSY BEIJING 1729
RUEHKO/AMEMBASSY TOKYO 2435
RUEHUL/AMEMBASSY SEOUL 1345
RHMFISS/DEPT OF ENERGY WASHINGTON DC
RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUEAIIA/CIA WASHDC
RHEFAAA/DIA WASHDC
RHEHNSC/NSC WASHDC 1925
RUEKJCS/SECDEF WASHDC 1775
RUEKJCS/JOINT STAFF WASHDC
RHMFIUU/CDR USCENTCOM MACDILL AFB FL
RUEHAST/AMCONSUL ALMATY 2198

UNCLAS SECTION 01 OF 03 ASTANA 000049

SENSITIVE
SIPDIS

STATE FOR SCA/CEN, EEB/ESC, S/EEE, S/CIEA
STATE PLEASE PASS TO USTDA

E.O. 12958: N/A
TAGS: PGOV PREL PINR ECON EINV ENRG SOCI KZ
SUBJECT: KAZAKHSTAN: AES CONSIDERS ALTERNATIVES TO ARBITRATION

REF: (A) 09 ASTANA 837
(B) 09 ASTANA 555

ASTANA 00000049 001.3 OF 003

¶1. (U) Sensitive but unclassified. Not for public Internet.

¶2. (SBU) SUMMARY: On January 15, a senior executive from U.S. power company AES told the Ambassador that the company has worked with Kazakhstan's Ambassador to the United States to prepare a settlement letter to the government to resolve a long-standing dispute over alleged antimonopoly behavior. The Ministry of Finance currently is reviewing the matter with regional officials from East Kazakhstan Oblast, where AES owns two combined heat and power plants, has concessions on two hydropower plants, and manages contracts for power distribution networks. Separately, the region's governor blasted AES in the local press, accusing the company of breaking the law by unilaterally raising electricity tariffs without regulatory approval. On July 31, 2009, AES filed a Notice of Dispute with an international arbitration court and has until February 11 to decide whether or not to file a formal request for arbitration. The AES executive expressed optimism about the possibility of a settlement if Prime Minister Masimov became personally engaged. END SUMMARY.

AES ASSETS IN EAST KAZAKHSTAN

¶3. (SBU) In Kazakhstan, AES owns two combined heat and power plants (the Ust-Kamengorsk CHP and the Sogrinsk CHP in Novaya Sogra), holds concessions on two hydropower plants (in Ust-Kamenogorsk and in Shulbinsk), and has management contracts for power distribution networks in East Kazakhstan. Shortly after taking office, the governor (Akim) of East Kazakhstan, Berdybek Saparbayev, extended AES's contract for five years, through February 2014, at a fixed fee of $100,000 per year.

THE CASE AGAINST AES

¶4. (SBU) In 2007, the government of Kazakhstan assessed AES a $200 million fine for alleged antimonopoly activities. AES has paid $29 million of the fine and has had another $6.5 million in assets

frozen. Because negotiations to resolve the dispute have not been successful, AES sent the Prime Minister a letter on July 31, 2009 to inform the government that AES will take the case to international arbitration. According to Regional Vice President Mike Jonagan, Samruk Energo subsequently pressured AES to sell its prized hydropower plants (ref A).

¶5. (SBU) During the Ambassador's visit to East Kazakhstan Oblast, Jonagan and Saparbayev expressed their optimism on August 20, 2009, that the dispute could be resolved amicably. Jonagan, however, privately alleged that other forces were at play, including the personal interest that President Nazarbayev's son-in-law Timur Kulibayev has shown in the AES-managed hydropower plants. He said that AES simultaneously filed for international arbitration and a London-court injunction to prevent a Kazakhstani joint-stock company from obtaining confidential information about the ownership and registration of shares in the AES-managed two hydropower plants. Jonagan claimed that this joint-stock company, which he suspects Timur Kulibayev owns or controls, has "made a strong push" for the hydropower plants. "Two or three years ago," he asserted, "someone -- most likely Kulibayev -- gave the order to start these court cases against us. Kulibayev has a personal interest in buying shares in these hydropower companies. He's now back in the game," as Deputy Chairman of Samruk-Kazyna, which owns Samruk Energo, which is the beneficial owner of the hydropower plants. "He got these legal issues started, and now it's taken on a life of its own."

¶6. (SBU) In response to AES's decision to seek international arbitration, Jonagan said the government has engaged an international law firm to represent their interests, the same firm that represented them during litigation with K-Mobile. Jonagan expressed his hope for an out-of-court settlement of the dispute and noted AES's willingness to amend the hydropower contracts in the

government's favor in order to "normalize relations and move forward with a clean slate."

¶7. (SBU) The Agency for the Regulation of Natural Monopolies (AREM) also has criticized AES for behaving like a short-term speculator, not a long-term strategic investor. AREM claims that more than 10 years after AES's initial investment, the company still has not made any major capital investments at the power plants it owns and operates. On a related note, the Almaty regional government continues to pursue back taxes from a trading company, long-defunct, that AES established when it first entered Kazakhstan.

AES PREPARED TO GO TO INTERNATIONAL ARBITRATION

¶8. (SBU) On January 15, Jonagan told the Ambassador that he met earlier that day with Vice Minister of Finance Ruslan Dalenov to discuss the charges against AES. According to Jonagan, Dalenov was defensive when told that local tax authorities had acted improperly, and he primarily was concerned about the financial cost of international arbitration. "I understand his position," Jonagan said. "He's under orders to delay, stall, delay, stall." Jonagan told Dalenov that AES has retained an expensive U.S. law firm to advise the company on the case and is fully prepared to file the necessary papers to formally request arbitration on February 11, when the Notice of Dispute expires. According to Jonagan, Dalenov asked if the government should hire its own law firm in response. "Considering that we have made zero progress despite six months of talks, I would say yes," Jonagan reportedly told Dalenov.

"NO SANITY IN THIS PROCESS"

¶9. (SBU) Jonagan indicated that its new power-tariff structure lies at the heart of the dispute, and could offer a way out of the impasse. "Currently," he complained, "there is no sanity in the (tariff-setting) process. Wholesale electricity prices and transmission costs have just increased by 25%. Every other retail power company in Kazakhstan received a tariff increase -- every one, except us." Jonagan said he told Dalenov that AES's inability to charge market rates for power in East Kazakhstan is driving the company inexorably to international arbitration. He suggested to the Ambassador that the government's agreement to a sufficient

tariff increase (at least 25%) might convince AES to drop its arbitration claim. "But that's going to be a tough pill for the Akim (governor) to swallow," Jonagan asserted.

EAST KAZAKHSTAN AKIM OUTRAGED

¶10. (SBU) On January 14, East Kazakhstan's Akim Saparbayev lashed out at regional power-distribution company Shygysenergotrade, which is owned by AES. According to local press reports, Saparbayev was "seriously disturbed" by the company's decision to increase electricity tariffs on January 1 without the consent of the regulator and to terminate power supply contracts with local enterprises. "As the head of the region, I will not tolerate violations of existing legislation in East Kazakhstan, and will not allow this company to agitate the population," Saparbayev was quoted as saying. Saparbayev reportedly also criticized AES for not meeting its social obligations.

¶11. (SBU) Jonagan told the Ambassador on January 15 that AES applied several months ago for an increase in the tariff, but the regional regulator returned the application and refused to forward it to AREM in Astana, because the company allegedly did not properly fill out the paperwork. Jonagan said that Shygysenergotrade then published a notice in regional newspapers in East Kazakhstan, announcing its intention to increase electricity tariffs effective January 1, "provided the company receives the necessary regulatory approvals." Jonagan noted that news reports, which republished the Shygysenergotrade announcement, omitted this critical disclaimer. In fact, Jonagan underlined, the company has not acted unilaterally to impose new rates, as Saparbayev was led to believe.

¶12. (SBU) Jonagan said he had a tough, tense discussion with Saparbayev on January 14 during which Saparbayev agreed to "do everything in his power" to enact a new tariff by January 26. Jonagan speculated that Saparbayev would push for a 10%, rather than the 25% or greater, increase that AES needs to remain competitive in the retail power market in Kazakhstan.

STAND OFF WITH KEGOC

¶13. (SBU) Local press also reported on January 15 that Shygysenergotrade received a telegram from national power-grid operator KEGOC demanding that it return 15 million kilowatt hours of power to the grid. KEGOC reportedly informed local authorities that Shygysenergotrade is violating Article 13 of the Law on Electricity and the March 19, 2008, Order of the Ministry of Energy and Mineral Resources, which determine the daily schedules for electricity generation and consumption. Jonagan told the Ambassador that the company cannot purchase the required amount of electricity and sell it at the low rate set for the company in 2010. "We are already $13 million in debt," he said. "We can't continue to sell electricity at a loss." Jonagan said AES has applied to AREM to negotiate a 25% rise in the tariff. He claimed that even an increase of that amount would enable the company to "just skate by. Anything less than that would be a disaster."

A MEETING WITH THE PRIME MINISTER

¶14. Jonagan told the Ambassador that AES senior executives contacted Kazakhstan's Ambassador to the United States, Yerlan Idrissov, who reviewed a draft settlement letter and recommended the company discuss the matter directly with Prime Minister Masimov. According to Jonagan, AES tentatively arranged to meet Masimov in Davos, Switzerland, during the World Economic Forum on January 23, but Post subsequently learned that Masimov cancelled his travel plans. Jonagan suggested that a meeting with Masimov -- preferably on the margins of another event outside Kazakhstan -- would help to resolve this dispute before it goes to international arbitration.

¶15. (SBU) COMMENT: The manner in which this dispute is managed will test the government's commitment to creating a favorable investment climate and honoring contract stability, as powerful interests in the East Kazakhstan region and at the center attempt to influence the outcome. We are encouraged by the continued

commitment of AES and the government to dialogue and negotiation, and will help facilitate a meeting between the U.S. company and the Prime Minister. END COMMENT.

HOAGLAND